

Message Text

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ACTION SS-25

INFO OCT-01 ISO-00 SSO-00 NSCE-00 /026 W
-----101041Z 122518 /15

O R 100850Z FEB 77
FM AMEMBASSY ROME
TO SECSTATE WASHDC IMMEDIATE 2691
TREAS DEPT WASHDC IMMEDIATE
INFO USMISSION EC BRUSSELS
USMISSION OECD PARIS

C O N F I D E N T I A L SECTION 1 OF 2 ROME 2176

EXDIS

TREASURY FOR SOLOMON AND BERGSTEN

E.O. 11652: XGDS - CAT. 1
TAGS: EFIN, IT
SUBJECT: ITALIAN APPROACH ON CONCLUSION OF IMF AND OTHER LOAN
NEGOTIATIONS

REF: ROME 1940

1. SUMMARY. IN MEETING ON FEBRUARY 9 TREASURY MINISTRY
DIRECTOR GENERAL PALUMBO ASKED TREASATT TO CONVEY FOLLOWING GOI
VIEWS ON CONCLUSION OF IMF AND OTHER FOREIGN LOAN NEGOTIATIONS:
(1) GOI HOPES THAT FUND MISSION CAN COME TO ROME AROUND
FEBRUARY 18-20 WITH VIEW TO COMPLETING NEW STANDBY NEGOTIATIONS
BY END-FEBRUARY; (2) NEGOTIATIONS SHOULD BE CONDUCTED DIRECTLY
BETWEEN HEAD OF FUND MISSION OF MINISTER OF TREASURY STAMMATI;
AND (3) ITALIAN PROGRAM SHOULD BE VIEWED AS CONTINUOUS ONE,
MERITING NEW IMF STANDBY OF \$1 BILLION AT LEAST OVER TWO-YEAR
PERIOD 1977-78. PALUMBO ALSO MENTIONED DESIRE OF MINISTER STAMMATI
TO VISIT WASHINGTON, POSSIBLY IN MARCH. END SUMMARY.

2. TREASATT WAS INVITED TO MEET WITH MINISTRY OF TREASURY
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DIRECTOR GENERAL PALUMBO FEBRUARY 9. PALUMBO MENTIONED THAT GOI
HAD BEEN VERY PLEASED WITH OUTCOME OF VICE PRESIDENT MONDALE'S
VISIT. IT HAD GIVEN GOI WELCOME OPPORTUNITY TO EXPLAIN
SERIOUSNESS OF ITALIAN ECONOMIC PROBLEMS, STRONG POLITICAL
CONSTRAINTS ON GOI ACTION, MEASURES TAKEN TO DATE, AND CONTINUED
DETERMINATION TO PURSUE ECONOMIC STABILIZATION EFFORT.
WHILE RECOGNIZING THAT NO COMMITMENTS HAD BEEN MADE, PALUMBO

FELT THAT MEMBERS OF U.S. PARTY HAD SHOWN CONSIDERABLE COMPREHENSION OF POLITICAL AND ECONOMIC REALITIES IN ITALY. NOW THAT INITIAL PHASE OF ITALIAN STABILIZATION PROGRAM WAS ALMOST COMPLETED, HE HOPED THAT SIMILAR SPIRIT OF COMPREHENSION WOULD PREVAIL WHEN USG DETERMINED ITS POSITION WITH REGARD TO FOREIGN FINANCIAL SUPPORT FOR STABILIZATION EFFORTS.

3. REFERRING TO FINAL LABOR COST MEASURE (REFTEL), PALUMBO SAID THAT HIS IMPRESSION WAS THAT, AFTER INITIAL "HYSTERICAL" REACTION BY SOME LABOR AND POLITICAL PARTY LEADERS, MORE MODERATE APPROACH WAS BEING TAKEN WITH REGARD TO TWO ASPECTS OF "FISCALIZATION" DECREE. THESE CONCERNED MEASURE TO STERILIZE FEEDBACK EFFECT THROUGH WAGE INDEXATION (SCALA MOBILE) OF TAX INCREASES AND MEASURE TO DISCOURAGE BUSINESSES FROM GRANTING ADDITIONAL WAGE RATE INCREASES AT COMPANY LEVEL BY DISALLOWING TAX DEDUCTION OF SUCH COSTS AND BY DENYING THEM BENEFITS OF FISCALIZATION. ("FISCALIZATION" CONSISTS OF ASSUMPTION BY TREASURY OF PART OF SOCIAL INSURANCE COSTS OF BUSINESS, TO BE FINANCED BY TAX INCREASES.) WHILE DECREE LAW EMBODYING THESE MEASURES HAS IMMEDIATE EFFECT, IT MUST STILL BE RATIFIED BY PARLIAMENT WITHIN SIXTY DAYS AND CAN BE AMENDED IN PROCESS. PALUMBO HOPED THAT IMF, EC AND OTHER LENDERS WOULD NOT WAIT UNTIL RATIFICATION TOOK PLACE BY WOULD PROMPTLY PROCEED WITH CONCLUSION OF LOAN NEGOTIATIONS. IN FACT, PALUMBO ARGUED THAT FOREIGN LENDERS SHOULD CONDITION NEW FINANCIAL ASSISTANCE ON RATIFICATION OF TWO CONTROVERSIAL MEASURES, SINCE THIS WOULD STRENGTHEN HAND OF GOI DURING RATIFICATION PROCESS. HOWEVER, HE MENTIONED NEED FOR ESCAPE CLAUSE IF TACTIC FAILED. (COMMENT: EMBASSY FEARS THAT THIS TACTIC COULD BACKFIRE AND PROBABLY GOES BEYOND WHAT IMF IS WILLING OR ABLE TO DO.)
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FINALLY, GOI STRONGLY HOPED THAT FOREIGN LENDERS WOULD NOT TAKE POSITION THAT, SINCE STABILIZATION PROGRAM IS NOT YET "COMPLETE," THEY SHOULD WAIT SEVERAL MONTHS UNTIL ADDITIONAL MEASURES ARE TAKEN.

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ACTION SS-25

INFO OCT-01 ISO-00 SSO-00 NSCE-00 /026 W

-----101049Z 122620 /11

O R 100850Z FEB 77

FM AMEMBASSY ROME

TO SECSTATE WASHDC IMMEDIATE 2692

TREAS DEPT WASHDC IMMEDIATE

INFO :USMISSION EC BRUSSELS 7994

USMISSION OECD PARIS

C O N F I D E N T I A L SECTION 2 OF 2 ROME 2176

EXDIS

TREASURY FOR SOLOMON AND BERGSTEN

4. PALUMBO SAID THAT GOI HOPED THAT IMF MISSION COULD COME TO ROME AROUND FEBRUARY 18-20 TO COMPLETE NEGOTIATIONS OF NEW STANDBY BY END OF MONTH. HE THOUGHT THAT FUND STAFF WAS ALREADY WELL INFORMED ABOUT ITALIAN EFFORTS AND ONLY NEEDED SHORT PERIOD OF TIME TO EVALUATE LATEST MEASURES. NEGOTIATIONS SHOULD BE CONDUCTED DIRECTLY BETWEEN HEAD OF IMF MISSION AND MINISTER OF TREASURY STAMMATI, HIMSELF. GOI WAS CONCERNED ABOUT DISTORTED PRESS LEAKS DURING NEGOTIATIONS. ALSO, TREASURY MINISTER STAMMATI FEELS THAT ONLY MINISTER OF TREASURY, WHO HAS POLITICAL RESPONSIBILITY FOR STABILIZATION PROGRAM (AND NOT BANK OF ITALY OR ANY OTHER ITALIAN OFFICIALS) SHOULD BE RESPONSIBLE FOR FINAL NEGOTIATIONS. WITH REGARD TO EC CREDIT, PALUMBO THOUGHT THAT COUNCIL OF FINANCE MINISTERS WOULD NOT YET GIVE FINAL APPROVAL TO \$500 MILLION EC LOAN AT ITS FEBRUARY 14 MEETING, ALTHOUGH THERE MIGHT BE SOME DISCUSSION OF ITALIAN PROGRAM.

5. TREASATT ASKED PALUMBO WHAT AMOUNT OF NEW IMF STANDBY GOI ASPIRED TO. PALUMBO SAID THAT IT WAS GOI HOPE THAT AGREEMENT COULD BE REACHED ON \$1 BILLION STANDBY. SUCH A STANDBY WOULD, HOWEVER, BE RELEASED OVER TWO-YEAR STABILIZATION PERIOD, I.E.,
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EXTENDING THROUGH 1978. IT WAS OBVIOUS THAT ITALIAN STABILIZATION PROGRAM IN ITS PRESENT FORM WAS NOT SUFFICIENT TO DEAL WITH ALL FUNDAMENTAL PROBLEMS. FOR EXAMPLE, SERIOUS EFFORT WAS REQUIRED TO LIMIT GROWTH OF BUDGET EXPENDITURES. PALUMBO SEEMED TO ASSUME THAT, IN ADDITION TO NEW STANDBY, TOTAL ASSISTANCE PACKAGE WOULD AT LEAST INCLUDE \$500 MILLION EC CREDIT AND ROLL-OVER OF 1974 IMF STANDBY REPAYMENT OF ABOUT \$825 MILLION. HE REFERRED TO EXCEPTIONALLY LARGE IMF STANDBY FOR THE UK AND TO ADDITIONAL LINES OF CREDIT IN CONNECTION WITH STERLING BALANCES AND EXPRESSED SOME CONCERN THAT ITALIAN ASSISTANCE PACKAGE NOT BE TOO SMALL VIS-A-VIS AMOUNT OF ASSISTANCE GIVEN TO UK, FOR FEAR OF ADVERSE PSYCHOLOGICAL EFFECTS IN ITALY. HE ADMITTED, HOWEVER, THAT IT WOULD BE NECESSARY TO AVOID GIVING ITALIAN PUBLIC THE IMPRESSION THAT ECONOMIC PROGRAM WAS NOW COMPLETE AND THAT NEW FINANCING WOULD MAKE IT

UNNECESSARY TO PURSUE FURTHER STABILIZATION EFFORTS.

6. PALUMBO SAID THAT TREASURY MINISTER STAMMATI, AS MENTIONED INFORMALLY DURING THE MONDALE VISIT, WOULD LIKE TO MAKE A VISIT TO WASHINGTON IN COMING WEEKS, BUT ONLY AFTER IMG STANDBY AND EC CREDIT NEGOTIATIONS HAVE BEEN COMPLETED, I.E., POSSIBLY IN MARCH. IN ANY CASE, ITALIANS WOULD CERTAINLY WANT TO AVOID GOING TO SUMMIT MEETING THIS SPRING WITH "HAT IN HAND," BECAUSE LOAN NEGOTIATIONS HAD NOT BEEN COMPLETED.

7. COMMENT. TREASATT GAVE PALUMBO PERSONAL OPINION THAT WAY IN WHICH STABILIZATION PROGRAM HAD DEVELOPED DID SEEM TO CALL FOR CONTINUING PROGRAM AND FOR GRADUAL APPROACH TO FINANCING. CERTAINLY, STABILIZATION EFFORTS WOULD HAVE TO CONTINUE THROUGH 1978, AND RELEASE OF FINANCING SHOULD BE TIED TO ECONOMIC PERFORMANCE

,
INCLUDING MID-YEAR REVIEW OF PROGRESS WHICH GOI ITSELF PLANS TO TAKE (BEFORE JULY 1). SOME BALANCE WOULD HAVE TO BE STRUCK BETWEEN ASSURING FINANCIAL MARKETS THAT SOME FINANCIAL SUPPORT WOULD BE AVAILABLE AND DANGER THAT TOO LARGE A FINANCIAL PACKAGE WOULD RESULT IN REDUCTING PRESSURE ON PUBLIC, UNIONS AND POLITICAL PARTIES TO PERSIST IN STABILIZATION EFFORT. TREASATT
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SAID THAT HE BELIEVED THAT BOTH IMF AND USG WERE CONCERNED ABOUT PRECEDENT WHICH WOULD BE SET WHENEVER FUND AGREES TO GRANT FIRST SUPER TRANCHE ASSISTANCE TO ANY COUNTRY. THEREFORE, THERE MIGHT BE SOME PROBLEM IN REACHING COMMITMENT FROM IMF ON A STANDBY AS LARGE AS \$1 BILLION. EMBASSY RECOMMENDATIONS AND ASSESSMENT CONTAINED ROME 2177 AND ROME 2175, RESPECTIVELY. BEAUDRY

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Message Attributes

Automatic Decaptioning: Z
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: LOANS, NEGOTIATIONS
Control Number: n/a
Copy: SINGLE
Sent Date: 10-Feb-1977 12:00:00 am
Decaption Date: 22 May 2009
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977ROME02176
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: X1 CAT. 1
Errors: N/A
Expiration:
Film Number: D770047-1047
Format: TEL
From: ROME
Handling Restrictions:
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770254/aaaabvpm.tel
Line Count: 204
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: e34d74c8-c288-dd11-92da-001cc4696bcc
Office: ACTION SS
Original Classification: CONFIDENTIAL
Original Handling Restrictions: EXDIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: EXDIS
Reference: 77 ROME 1940
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 10-Mar-2005 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3353794
Secure: OPEN
Status: NATIVE
Subject: ITALIAN APPROACH ON CONCLUSION OF IMF AND OTHER LOAN NEGOTIATIONS
TAGS: EFIN, IT, IMF, (PALUMBO)
To: STATE TRSY
Type: TE
vdkgvwkey: odb://SAS/SAS.dbo.SAS_Docs/e34d74c8-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009